

JONES EDUCATION NETWORKS™ INC

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF GENERAL COUNSEL

June 29, 1994

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Re: Implementation of Sections of the Cable Television
Protection and Competition Act of 1992;
Rate Regulation MM Docket No. 92-266

Dear Mr. Chairman:

As Chief Executive Officer of Jones Education Networks, Inc. ("JEN"), I am writing to express my alarm and concern over the severe impact that some of the Commission's new cable rate regulation rules are already having and will continue to have on the development and viability of cable programming services.

JEN owns and operates Mind Extension University (ME/U): The Education Network, the only 24-hour cable television network solely devoted to education via "distance learning". ME/U embodies a longstanding vision and commitment of Glenn R. Jones, the Chairman and Chief Executive Officer of JEN's parent company Jones International, Ltd., to use cable television to meet the educational imperatives of the information age. ME/U enables cable subscribers to take college level courses for credit in their own homes, for which they can ultimately receive undergraduate and graduate degrees from 30 highly respected colleges and universities from all parts of the United States. It also offers pre-college courses and courses that might be taken for self-enrichment on a non-credit basis. Using cable technology, ME/U

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The Honorable Reed E. Hundt
June 29, 1994
Page - 2 -

provides a means for all people to overcome the barriers of cost and access to quality education.

ME/U was launched in 1987, and thus was not among those very first groups of satellite program services that became available to cable operators and subscribers and that filled the relatively low channel capacity of the cable systems of the 1970s and early 1980s. Like other new services that began operations in recent years, ME/U's growth has largely depended on the addition of new channels of service by cable systems. Although the marketplace of programming services in which we compete is highly -- and increasingly -- competitive, ME/U has been quite successful in gaining access to newly activated channels on cable systems. Today, we reach 25.6 million television households. But more than half the cable households in the nation still do not have access to ME/U. And what is most troublesome and alarming is that the steady growth in our subscribership has stalled -- not only because cable systems are choosing other satellite networks instead of ME/U to fill newly added channels (in particular, channels requested to be carried in exchange for retransmission consent) but also because they simply are not adding new channels of non-premium services. There's nothing especially mysterious about this development; it is quite clearly the result of the Commission's rate regulation rules.

The Rules Are Stunting ME/U's Growth

The Cable Television Consumer Protection and Competition Act of 1992 created financial uncertainty from the day it was enacted, as cable operators and programmers waited to see how the Commission would implement its regulatory scheme. But the rules ultimately adopted by the Commission exceeded our worst fears. We understood the Act to require that cable operators offer a basic tier containing all the broadcast signals on the system at reduced rates. And we expected that rates for non-basic tiers of satellite services would be set at levels that required reductions by those that had raised rates most egregiously and that prevented all systems from increasing rates too precipitously in the future. But nothing in the Act or the legislative history suggested that the overall rates of virtually all systems would be presumed to be unreasonable -- much less that they would be subject to rollbacks of as much as 17%. It is not surprising that the prospect of rate reductions of this magnitude has made cable operators wary and risk-averse when it comes to investing in new channels of programming on regulated tiers.

The Honorable Reed E. Hundt

June 29, 1994

Page - 3 -

The Commission has seemed genuinely concerned that its rate rollbacks not stifle the growth and development of new programming. But its efforts to insulate new programming from the effects of rate regulation have, so far, proven to be completely ineffective. In particular, the Commission's formula for allowing rate increases when new channels of programming are added to regulated tiers provides cable operators with virtually no incentives for adding such channels. Under that formula, cable systems are allowed, when they add a channel, to pass through to subscribers the additional monthly cost of the programming, plus a 7.5% markup. (The formula also allows an additional markup of a flat amount, which depends on the number of channels on the system, but, for most systems, that amount is negligible -- one or two cents.) For most satellite-delivered services that are not already available on most systems, an approach based on a pass-through with a percentage markup is, on its face, misconceived.

To understand why this is so, consider, as an illustrative example, the way that ME/U markets its service to cable systems. Basically, ME/U understands that, while cable subscribers have demonstrated that they want -- and are willing to pay for -- additional choice and diversity on their systems, the incremental amount that they are willing to pay at the outset for a new channel of service is minimal. Moreover, cable operators incur certain costs when they choose to add a new channel of service. In addition to the costs of activating new channel capacity, they incur costs associated with notifying subscribers of the change in service, marketing and promoting the new service, and dealing with the rate regulation procedures that are triggered by changes in service offerings. Finally, we recognize that, for the cable operator, there are alternatives to devoting new channel capacity to a regulated, tiered service. Pay-per-view, for example, offers a predictable revenue stream with none of the constraints of rate regulation.

The upshot of all these considerations is that, to induce a cable operator to carry a new service like ME/U, we need to make the service available at a price that enables the cable operator to recover its costs and a reasonable profit that at least matches what it could earn from alternative uses of a channel. Because cable operators seem to need to recover amounts at least in the 30 to 50 cent range, and because the incremental amount that subscribers will pay for a new, relatively unknown channel does not greatly exceed this range, it is obvious that we have to provide our service at the outset at a very low price -- and we do. Because ME/U needs to establish viewership and brand-name recognition if it is to grow, we are willing to offer the service to operators for only a few cents per subscriber per month.

The Honorable Reed E. Hundt

June 29, 1994

Page - 4 -

This marketing approach worked fine in the absence of rate regulation. To the extent that adding ME/U enhanced the value of cable service to subscribers, cable operators were allowed to capture the lion's share of this added value through rate increases, while ME/U received only a small portion through its small fees for carriage. The Commission's new formula for adding channels in a regulated environment, however, stands this approach on its head. Now, cable operators can only recover 7.5% of any additional fees paid by subscribers, while ME/U retains the remaining 92.5%. In other words, if ME/U now offers its service to cable operators for five cents per subscriber, the cable operator can no longer increase rates for the tier by 35 cents and retain 30 cents; it can only increase rates by 5.375 cents and retain 0.375 cents. This minuscule return is simply not enough to induce cable operators to add a new channel of service, and, therefore, operators are now simply unwilling to add ME/U even when we offer it at very low rates.

But if the problem is simply that 7.5% of our low rates is insufficient to cover the operators' risks and costs of adding the service, why don't we just charge more for the service? If we charge the operator more, it gets to keep more; that's how a percentage markup works. This would, of course, be a perverse result. It makes no sense for regulators to encourage programmers to charge operators more for their programming, with these increased charges to be passed through to subscribers. But operators would not agree to such a scheme in any event. To enable an operator to keep an extra penny under a 7.5% markup approach, a programmer would need to increase its fee to the operator by 13.33 cents. If the operator needed to recover 50 cents per subscriber to justify adding a service, the programmer would have to charge the operator \$6.66, and the operator would have to increase its rates to subscribers by \$7.16. This would provide a bonanza for the programmer but would be a losing proposition for the operator; the decline in subscribership that would result from such a rate increase would surely offset the additional 50 cents earned from each remaining subscriber.

What about the à la carte option? If ME/U were offered on a per-channel basis instead of on a regulated tier, it could be offered at unregulated rates, allowing cable operators to purchase the service at low rates and sell it to subscribers at whatever rates were necessary to provide sufficient incentives to carry the service. But it is unrealistic to think that a recently introduced service like ME/U can successfully be marketed as an à la carte service. Such services need to maximize their potential viewership, and this means that they need to be available for sampling on widely available tiers that include other, more established services.

The Honorable Reed E. Hundt

June 29, 1994

Page - 5 -

**The Rules Will Make the Launch of
New "Distance Learning" Channels Impossible**

If the Commission's approach has stalled the growth of ME/U, its effect on new services that JEN hopes to launch in the near future will be even more severe, if not fatal. JEN has already announced the creation of three such services, all of which are intended to further the goals of distance learning and self-enhancement. One of those services, Jones Computer Network, has been operating since May 17, 1993 as a prime-time segment on ME/U. It provides informational and educational programming about computers and digital technologies, to bring computer novices into the information age while keeping computer experts abreast of the most recent digital developments. While continuing to operate as a segment on ME/U, Jones Computer Network will launch as a full-time network on the GE Americom C-3 satellite later this summer.

The other two educational services will follow the same introductory route, appearing first as segments of ME/U before being launched as full-time satellite networks. The Health Network, which will be designed not only to inform audiences on wellness but to provide educational opportunities and certification in health-related fields, will be launched full-time in 1995. The Language Network, to be focused on foreign language training and international cultural and business matters, will be launched the following year.

All these services will be advertiser-supported. They are all designed to be marketed in the same manner as ME/U -- with low fees to subscribers to induce operators to carry services that are untested and have no brand name recognition. And, therefore, the launch and viability of these services is, for the reasons described above, severely threatened by the Commission's current rules for adding new channels to regulated tiers.

Even in the absence of regulation, the survival of ME/U and its progeny would, of course, be no sure thing. The video marketplace is highly competitive, and for every new service that has succeeded, many have struggled and failed. But JEN, its parent company, and its founder have more than a commercial interest in these services. We are committed to making distance learning a reality, and we believe that, in an unregulated environment, our services would succeed. It would be ironic -- indeed, it would be tragic -- if a law intended to promote consumer interests resulted in regulations that not only stifled the growth of new and diverse programming but also prevented consumers from reaping the benefits of distance learning.

A Solution: A Reasonable Fixed Markup

The best solution -- short of revisiting the Commission's "tier-neutral" approach to rate regulation and its determination that all rates charged by systems not subject to effective competition were "unreasonable" -- would be to replace the current formula for adding channels with one that more closely replicated marketplace conditions and incentives. A pass-through of programming costs plus a percentage markup will not work, but a pass-through of programming costs plus a fixed markup could restore incentives to add new programming if (1) the fixed markup were sufficient to cover an operator's costs in adding the channel (and at least comparable to what the operator could earn from alternative unregulated uses of the channel, such as pay-per-view) and (2) the resulting rate reasonably approximated what subscribers would be willing to pay for additional new programming services.

Suppose, for example, that a 30-cent pass-through were sufficient to meet both these conditions (as we have been told by operators would be the case). Then, if JEN made ME/U or the Jones Computer Network available to a system for 3 cents per subscriber, the system could increase rates by 33 cents, with the system retaining 91% and JEN retaining 9%. That is a much more realistic approach than the existing formula, under which, if the system increased rates by 33 cents, it would retain only 7.5% -- or if it were to retain 30 cents, JEN would have to charge \$4 and subscribers would have to pay \$4.30. A 30-cent pass-through works for all parties. A programmer like JEN is able and willing to make its programming available at low rates at the outset in order to induce systems to carry the programming; a 30-cent markup on this low cost programming will make it possible for operators to add channels of programming and, we believe, will give them incentives to do so; and cable subscribers will be able to receive additional channels with modest rate increases that reflect what they have in the past been willing to pay for more viewing options.

Most importantly, such a revised approach would resuscitate the development of new programming services that are intended for, and can only survive on, the widely available tiers that include established services. It would allow existing services that have not yet reached their critical mass, like ME/U, to continue their growth and expansion and it would make it possible to launch new services like Jones Computer Network, the Health Network, and the Language Network, all of which are severely threatened by the deep freeze that the existing rules have imposed on carriage commitments.

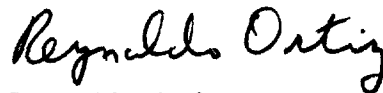
The Honorable Reed E. Hundt

June 29, 1994

Page - 7 -

We are committed to pursuing our goal of promoting distance learning on cable television, and I believe that cable operators want to share in our efforts. But, to make this happen, the rules will have to change. I urge the Commission to recognize the urgent need to revisit the rules for adding channels and to revise them in the manner described above, so that we -- and other programmers -- can offer cable subscribers the new options and opportunities that they want and deserve. In this regard, we at JEN would be most interested in meeting with you in the near future to discuss our concerns and to assist the Commission in crafting an appropriate regulatory approach.

Very truly yours,

A handwritten signature in black ink, reading "Reynaldo Ortiz". The signature is written in a cursive, flowing style.

Reynaldo Ortiz

RO/

cc: The Honorable James H. Quello
The Honorable Andrew C. Barrett
The Honorable Susan P. Ness
The Honorable Rachelle B. Chong